

The Soviet Economic System - II

Goals, Capabilities, Limitations, 1959-1975

We now move ahead in our survey to consider the future economic prospects of the Soviet Union -- its goals, capabilities and limitations. In the broadest sense, the goals set for the Soviet economy by the Kremlin leadership reflect the goals of international Communism.

The basic goal is the liquidation of our form of free society and the emergence of a Sovietized world order. The Communist leaders change their techniques as circumstances dictate. They have never given us the slightest reason to hope that they are abandoning their overall objective. They firmly believe, and eloquently preach, that Communism is the system which will eventually rule the world. Each move they make is directed to this end.

During the past year, there has been a distinctly hardening tone in Soviet foreign policy. This shift appeared justified to the Soviet leaders because of their conviction that there had been an enhancement of the Bloc's power position and a decline in that of the West. They believe that the "struggle against imperialism" has now entered a promising phase, that the shift in the relation of forces in the world to the advantage of the Communist Bloc is irrevocable. Of course, the claim to be pursuing policies in the interest of establishing "peaceful coexistence" is still made.

What is peaceful coexistence? In the words of former Soviet foreign minister Shepilov, and here I quote,

"Peaceful coexistence does not mean a quiet life. As long as different social and political systems exist, contradictions between them are inevitable. Peaceful existence is a struggle -- a political struggle, an economic struggle, an ideological struggle."

Shepilov should have prominently stated that it is also a military struggle. But the Kremlin leaders do not tell the Russian people how much is being spent on armaments. In their annual published budget, so-called "defense expenditures" are a single line entry. It is not broken down in any way. We know, from our studies of Soviet order of battle, procurement, military construction, and research and development, that the announced defense expenditures can cover little more than half the total amount the Soviets actually spend for military purposes each year. Their continuous diversion of economic resources to military support is without any parallel in peacetime history.

Why so much effort on the Soviet military establishment?

First of all, there is the need to maintain internal security, and to keep the European Satellites in the Communist Camp; to be able to deal quickly and ruthlessly with the Hungarians, the Poles and the East Germans.

Most importantly, there is a need to develop advanced weapons systems, to strive for a military breakthrough which would resolve the present nuclear stalemate in the Soviet's favor. Should they succeed in gaining clear-cut military superiority, the Communists would have a weapon for political threat and blackmail which could prove decisive, even short of a hot war.

Further, as new types of weapons are manufactured, the Soviet Union generates large stocks of obsolescent arms which are most useful to them. These arms can be used by the Communist leaders to advance their cause in local wars by proxy -- Korea, Vietnam and Malaya are typical examples.

Also, obsolescent arms sold at cut rate prices, have provided the key that opened the door to Soviet influence in many countries of the Free World. The September 1955 arms deal with Egypt was the first of these; shipments to Syria, Yemen, Afghanistan and Indonesia followed. As the world now knows, these have been profitable investments in disorder. Most recently, Soviet arms have gone to Guinea as a gift. They were quickly followed by a military mission and later a trade mission. Thus, for the first time, we see the familiar pattern of Communist penetration developing in the promising area of Black Africa.

What of the future? First, I would caution you that long-range projections of Soviet military expenditures are subject to wider margins of error than the other statistical estimates we will be considering later on this morning. We can be far more confident, for example, in

stating what Soviet steel production will be in 1965, simply because we know a great deal more about Soviet industrial intentions than we do about their military intentions.

However, if we project past trends forward, we can see that Soviet military expenditures by 1965 could easily be 50 per cent higher than they are today. Such a level of spending would impose no greater relative burden on the Soviet economy than do present military outlays. One prediction, I believe, can be made with absolute certainty. Unless we reach an effective disarmament agreement with the Soviet Union, there is just no chance for the United States to hold its defense expenditures at or near the present \$40 billion level. They must inevitably rise in response to the Soviet challenge.

I will now turn from military expenditures to some of the highlights of economic growth.

The new confidence of Khrushchev, the shrewd and vocal leader of the Soviet Communist party, and incidentally head of government, does not rest solely on the conviction that he, too, possesses great military power. He is convinced that the final victory of Communism can be achieved mainly by non-military means. Here the challenge of economic growth is of fundamental importance.

The proceedings of the 21st Party Congress, held in February of this year, laid out what we might call the Soviet economic order of battle. Khrushchev explained Soviet planned development for the next seven years

in these words, to summarize the ten hours of his opening and closing remarks:

"The economic might of the Soviet Union is based on the priority growth of heavy industry. This will insure the Soviets victory in peaceful economic competition with capitalist countries. Development of Soviet economic might will give Communism the decisive edge in the international balance of power; it will attract millions of new adherents to our side."

The seven year plan establishes the formidable task of increasing industrial production 80 per cent by 1965. The achievement of this goal would narrow the gap between Soviet industrial output and U.S. industrial output, particularly as far as basic raw materials and producers goods are concerned. Let me show you some specific figures.

(Briefing Aid 1)

1. This chart compares planned 1965 Soviet production of certain key products with actual United States output for the year 1957. I have used our 1957 production to avoid the recession year of 1958, which would be less favorable for the United States.

2. You can see that by 1965, the USSR plans to exceed our 1957 levels of production for aluminum, machine tools, electric power generators and cement.

3. Production of steel and petroleum, while substantial, would still be below present U.S. levels.

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Of course, what we have been comparing is 1957 U.S. output with planned Soviet production in 1965. The United States will not be standing still over the next seven years. But our rates of growth will not match those of the Soviet Union. During the past seven years, through 1958, Soviet industry has grown at the annual rate of  $9\frac{1}{2}$  per cent. This is not the officially announced rate, which is somewhat larger. It is our reconstruction and deflation of Soviet data.

Our own industrial growth has been at an annual rate of 3.6 per cent for the seven years through 1957. If one included 1958, the comparison with the rate of Soviet growth would be even less favorable. This means that, for the decade of the 1950's, the USSR has been moving ahead industrially about  $2\frac{1}{2}$  times as rapidly as has the United States. Do the Soviets intend to continue this pace?

In the arena of economic intentions, the leaders of the Soviet Union have left no room for doubt. The obsession with overtaking the U.S. economy in the shortest possible historical time period was the dominant theme of the propaganda barrage at the 21st Party Congress. In Khrushchev's words,

"The Soviet Union intends to outstrip the United States economically... To surpass the level of production in the United States means to exceed the highest indexes of capitalism." Visitors to the Soviet Union report the slogan "Even America must be surpassed," plastered on every awlarn.

We are now at an historical period in the race for economic supremacy, the point where the absolute gap between U.S. and Soviet production is

beginning to close. A simple way to get a feel for total additions to plant capacity is to compare industrial investment in the two countries.

(Briefing Aid 2)

1. This chart compares capital investment in industry in the years 1957, 1958 and 1959 for the Soviet Union and the United States, in dollars. It shows that Soviet outlays surpassed those of the United States, in absolute amount, in 1958 for the first time in history.

2. If you look at 1959, a year of recovery in the United States, such expenditures in the Soviet Union were about 7 billion dollars more than our own, which is a very substantial margin.

3. The implications for the future are disquieting. In a period of two years, Soviet investment outlays have moved up 37 per cent. We are left with the unpleasant prospect that, from here on in, the gap between the URSR and US in this important element of national power will continue to widen in favor of the Soviets.

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In this context of constant emphasis upon growth and economic competition with the United States, the Seven Year Plan and the struggle to fill or even overfulfill its goals assume an importance even beyond the actual content of the plan.

I do not wish to leave the impression that rapid growth can be sustained indefinitely without effort. One important factor is that the productivity of capital is declining in the Soviet Union, which means that future gains will not be achieved as easily as those in the past.

Every million tons of steel capacity added to existing plants will require the outlay of many more rubles than used to be the case. Even the extensive use of technological innovation will not be able to offset this decline in the productivity of capital. As usual, I have some figures.

(Briefing Aid 3)

1. This chart, covering the 14 year period, 1951-65, is a conversion of rubles to index numbers, using 1951 as a base of 100. You can see that total fixed capital must increase far more rapidly than total output (here measured in gross national product) if the production goals of 1965 are to be met.

2. The bottom line is the ratio of fixed capital to GNP. What this shows is that the productivity of capital dropped about 16 per cent between 1951 and 1958, and is expected to drop another 10 per cent by 1965. Over the 14 year period then, this is a decline of about 25 per cent.

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The Soviets are well aware of this problem. In the Seven Year Plan directive, the investment program is emphasized alternatively with plaudits for its enormous size and exhortations for maximum economies in its execution. State investment alone is to total more than two trillion rubles. This sum is claimed to be almost equal to total investment in all the preceeding years of Soviet rule. Such a program reflects the continuing need to substitute capital for labor if the economy is to be kept growing at rapid rates. By its very size, it introduces an uncertainty



in the Seven Year Plan -- that is, whether or not it can be carried out rapidly enough. If the machinery and equipment cannot be put in place on schedule, then the output goals may not be met, because of the general shortage of labor.

Turning from this brief discussion of investment in the broad, I would like to discuss a closely related problem -- that of managerial incentives. Plant managers in the Soviet Union are paid primarily by a bonus system, which in turn is based on the physical volume of production achieved during the year. This means that costs of production are not important in managers decisions. On the contrary, the present system is a positive disincentive to introduce new machinery and technology. Inevitably, overhauling a production line implies an initial period of no production while the equipment is being installed, and a subsequent period of low output while the inevitable bugs are being worked out of the new production line. Therefore, a plant manager who makes radical changes in his production facilities, to cut costs and save labor, is financially penalized.

At the same time, widespread mechanization and automation of Soviet industry is needed to meet the output goals of the new seven year plan.

The Central Committee of the Communist Party of the Soviet Union met on this problem during June of this year. They produced no solutions, but laid down the most thorough-going program in this field ever presented in the USSR. The more important directives coming out of this meeting

can be summarized as follows:

1. Gosplan and the State Committee for Automation and Machine Building will see to it that all branches of industry work out within three months standardized regulations for developing and testing new machines and handing them over to series production.

2. Gosplan and the Ministry of Finance will work out and submit to the Council of Ministers by 1 September 1959 proposals for improving financial methods for introducing new machines. This would include the setting of prices which would not only stimulate the manufacture of new machines but also their use.

3. Gosplan, the Ministry of Finance and various other government agencies, will prepare by 1 November 1959 proposals for establishing what was called "the necessary economic stimuli" to encourage factories to introduce new technology.

Just what these new "economic stimuli" will be is, of course, uncertain. However, it seems almost certain that bonuses for plant managers are going to be based on a combination of costs of production, together with the traditional volume of production method. This may come fairly close to the American method of profit sharing, and another piece of traditional Communist dogma will go out the window.

As I see it, the only alternative to moving closer to the system of managerial rewards used in capitalist countries would be to move to far more centralized control. Such a step would mean that, for each plant, the center in Moscow would prescribe the precise technological

processes that must be introduced, as well as the detailed time table for each re-equipment program. If the Soviet leadership were to take this alternative path, they would have to completely reverse the program for decentralization of decision making which was the heart of the organizational reform of 1957. The bureaucracy in Moscow would be back in the business of making day-to-day decisions about the thousands of industrial plants in the Soviet Union. This method of management completely stifled local initiative prior to the reform of 1957. Well, I hope this discussion casts some light on the reasons for the conclusion I stated earlier, that Communism is not a particularly efficient production system.

To move ahead with our survey, I will now turn to the position of the Soviet consumer in the Seven Year Plan. In terms of both consumer goods output and prospective increases in real wages, the Soviet citizen will experience a slower rate of improvement through 1965 than has occurred in the preceding seven years. The output of light industry (textiles, clothing, and footwear) is planned to increase at six per cent a year. Despite these increases, the volume, per capita output and quality of Soviet textiles and footwear will remain far below those of the United States last year.

The production of durable consumer goods, especially household appliances, is scheduled for large percentage increases. However, the level of output of most such items is currently so low that 1965 production will not be at all impressive by U.S. standards.

In contrast to the plan for industry, where prospects for meeting goals are reasonably good, the plan for agriculture is unrealistic. The goal, a 70 per cent increase over 1958, appears impossible of achievement. The quick and easy gains of the past, made possible by the extension of grain acreage in the "new lands," and by the corn program, have no counterparts in future agricultural programs. Our agricultural experts believe that if Khrushchev actually realizes a 30 per cent increase (in contrast to the planned 70 per cent) by 1965, he will be doing well. Furthermore, the slower growth of agricultural industrial crops, such as

cotton, will necessarily limit the increase of manufactured soft goods.

In terms of overall welfare, the Soviet consumer will still be shortchanged. And when the Kremlin leadership promises that the Soviet standard of living will be the highest in the world by 1970, this is absolute nonsense.

(Briefing Aid 4)

1. What this chart does is to compare per capita availabilities of certain key components of a consumer welfare index for the US and the USSR. The U.S. figures are actual 1958 availabilities; the Soviet figures are 1965 planned.

2. Starting off with cloth of all types, including wool, cotton, silk and synthetics, you can see that the Soviets plan to produce less than half the per capita availabilities in the U.S.

3. Moving on to shoes, the Soviet figure here is 66 per cent. However, this statistical comparison favors the Soviet Union, because it omits consideration of quality, and because certain types produced in quantity in the United States, such as women's sandals, are not included in our figures.

4. The much publicized next goal, of equalling the U.S. by 1960-61 has passed into history. The plan now is to get to 35 per cent of our 1958 level by 1965.

5. The last two figures are inventories not annual production figures, because annual production adds only a small percentage to the inventory.

As far as passenger cars are concerned, the Soviets expect to be slightly over one per cent of the U.S. per capita level by 1965. As far as living space, or housing, is concerned, the Soviet goal is 18 per cent of present U.S. This will provide 7 to 7.5 square meters per person by 1965, which is below the Soviet's own minimum health standard of nine square meters per person.

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It is clear that the Soviet Union still regards consumption primarily as a cost of production, required to secure economic growth and military power. Living standards are not going to be permitted to rise fast enough to interfere with the priority goals of Communism.

So much for the Seven Year Plan, and the prospects for military spending, industrial growth, agriculture and consumer welfare through 1965.

The terms of reference of this series of lectures requires a 15 year look into the future. What are the longer-term implications of the trends we have been considering? It is important to realize the seriousness of the Soviet challenge; it is equally important not to exaggerate their prospects in the economic race. In the propaganda surrounding the 21st Party Congress, Khrushchev made a number of statements about Soviet economic power which were nothing more than wishful thinking. Specifically, he stated that,

"After the completion of the Seven Year Plan, we will probably need about five more years to catch up with and outstrip the United States in industrial production. Thus

by that time (1970), or perhaps even sooner, the Soviet Union will advance to first place in the world, both in the absolute volume of production and in per capita production."

First of all, I would like to start with a projection of total production, or gross national product, in the two countries.

(Briefing Aid 5)

1. You can see that, measured in constant dollars, the Soviet Union's total output grew from about 33 per cent of that of the United States in 1950 to 41 per cent in 1957.

2. Based on present intelligence estimates, it is believed that their total output will be about half of our own in 1965.

3. Beyond the end of the present planning period, projections are, of course, more risky. I have estimated that the U.S. economy will grow at 3.7 per cent a year, which is higher than our long-term rate, and equal to a quite favorable past period of growth. I have projected Soviet growth from 1965 to 1975 at  $6\frac{1}{4}$  per cent a year, which is below their best postwar growth performance, but about equal to the achievement of the past two years.

4. If these trends are reasonably accurate, the United States will still command a very large lead by 1970. However, the decade of the 1970's will see the gap closing rapidly, with total Soviet output by 1980 equal to about three quarters of ours.

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Moving from total production, which includes industry, agriculture and services, and considering industry alone, the picture for the United States is not so favorable. By 1980 Soviet industrial production will be about equal to our own, and could well exceed U.S. output moderately. Its production of producers goods will be significantly higher than ours, while its output of consumer goods will be significantly less.

All of these forecasts, of course, assume that nothing will happen in the United States to sharply increase our rate of growth, and that nothing will happen in the USSR to sharply decrease that country's economic progress. To summarize, the exaggerations of Soviet propaganda should not blind us to the sobering implications of our prospects in the economic race.

I turn now to the external aspects of Soviet economic growth, to the question of its impact on underdeveloped countries of the Free World.

The Communists believe that the underdeveloped countries represent the Achilles heel of the Western World. These countries have assumed a role similar to that of the proletariat in early Marxism. To the Kremlin leaders, the Free World underdeveloped nations offer the greatest opportunities for an extension of Communism; it is the "duty" of the USSR as the vanguard of the revolution to invest some of its resources in promoting this extension.

The tactical shift in Soviet foreign policy to aid the newly emerging bourgeois governments was unveiled to the world in 1954. The party line turned from the "armed struggle" phase of the late Stalin era to a phase of "peaceful coexistence." As part of the "peaceful coexistence"



program, the Soviet Bloc began a "trade and aid" offensive.

When the Communist economic offensive started, many Western observers belittled Soviet capabilities to provide aid to underdeveloped nations. These observers believed that internal Soviet requirements for machinery and equipment, generated by the program of forced draft industrialization, would leave no surplus for export.

The judgment overlooked the fact that the Soviet Union had become a major industrial power in the world. By 1953, its annual production of industrial goods was already running over 70 billion dollars a year. Further, industrial output was increasing at an annual rate of nearly 10 per cent.

It clearly follows that the Soviets possessed the industrial muscle to step up Communist activities in the Free World by economic means; all that was needed was the political decision to do so. A diversion of less than one per cent of annual output was enough to support an aid program of significant proportions.

The aid program is not a large one by United States standards. Total credit extensions by the USSR over the past four years have only amounted to 1.6 billion dollars, and the net annual drain, that is the difference between drawings and repayments, has never amounted to more than half a billion dollars.

The main point is that of all Soviet outlays for national policy purposes -- defense, domestic investment, etc. -- foreign aid imposes far and away the smallest drain on resources. It could be increased substantially if the Communist leadership saw politically profitable opportunities to do so.

By 1965, the Soviets could have a foreign aid program equal to ours with still no observable strain on its economy. It seems inescapable that the economic competition will grow. This is part of what Khrushchev meant when he told Walter Lippman, "Economically speaking, we will cause you Americans more trouble every year."

Up to this point in time, Soviet Bloc aid to all underdeveloped countries of the Free World has been dwarfed by Western aid. However, it is important to keep in mind that Communist economic assistance is heavily concentrated in a few key target countries.

In these countries, the Soviet program is either larger than the aid provided by the United States, or is sizeable enough to be of considerable importance. Here are some examples.

(Briefing Aid 6)

1. The bars in this chart compare U.S. aid and Bloc aid from 1954 to the first quarter of 1959 for selected countries.

2. You can see that in Egypt, Syria, Iraq, Afghanistan, Ceylon and Indonesia, the Bloc has put in far more economic aid than we have. Although not shown in the chart, the same is true for Yemen.

3. In Burma, India, and Nepal, while Bloc economic aid is less than our own, it is nevertheless substantial. This applies to Cambodia as well.

These countries have been willing to expand their economic contacts with the Soviet Bloc for a variety of reasons, but a basic explanation of the success of the Soviet aid program lies in the fact that the underdeveloped countries are in capital-starved areas. Many leaders in these countries, in fact, have voiced their suspicions of Soviet intentions, but have defended their acceptance of Bloc assistance on the ground that the great need for additional capital justified the risk.

The leaders of world Communism are alert to the opportunity which this great transformation affords them. In their radio broadcasts to Africa, the Middle East and Asia, and through their local front organizations, the Soviets project the image of the Soviet system as the magic blueprint for achieving rapid progress. We should not underestimate the attraction which such an image has on men of influence in underdeveloped countries who are desperately seeking to lead their people into the Twentieth Century.

Let me show you one piece of Soviet propaganda, which was being used in India last year.

(Briefing Aid 7)

This chart, prepared in the Soviet Union, compares industrial growth in the USSR and in the United States in a highly exaggerated fashion.

It begins and ends with a recession period for the United States - 1948 and the first quarter of 1958.

Using 1948 as a base of 100 per cent in both countries, the chart creates the impression that by 1957, Soviet output had grown five times as fast as that in the U.S. But in 1948, of course, Soviet output was still much depressed because of the war's destruction.

If you follow the line representing the U.S., you see that as this chart is made up, the first quarter decline in 1958 wiped out U.S. production increases in recent years.

You see Uncle Sam - pot-bellied and dark-spectacled, bending backwards to view the exalted level of Soviet production. As an added bit of Socialist realism, Uncle Sam's leg is conveniently placed to hide our best years of growth.

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The Soviet policy of economic penetration fits like a glove into their world-wide campaign of subversion. There are over 6,000 Bloc technicians in the Free World, helping to train military forces and to build various industrial plants, the largest of which is the Indian steel mill. These technicians do not engage in propaganda or in subversive activities. Together with the Communist built plants, these technicians do serve to establish a peaceful Soviet "presence"; to lend credence to Soviet statements of disinterested help in achieving economic progress.

Meanwhile, the Communist propaganda goes out through the front organizations, directed overtly or covertly from Moscow. One of these organizations in India is the Indo-Soviet Cultural Society. Let's take a look at it.

(Blafing Aid 8)

1. You can see that this Indo-Soviet Cultural Society virtually blankets the country.
2. Several of its branches are located in Madhya Pradesh State, where the Russian-built steel mill is being completed.
3. Communist propaganda, similar to the slide I showed you earlier, comparing U.S. and USSR industrial growth, is distributed by such front organizations.

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What you have seen on this slide is only one Communist front organization. But the Soviets and their Chinese Communist allies have organized a vast number of fronts, covering almost every branch of human enterprise. They include youth and student groups, labor and veterans organizations, women's groups, and, of course, the World Peace Council with its innumerable peace societies. In total, the claimed membership of all fronts runs into several hundred million people.

Soviet trade with the underdeveloped nations is motivated primarily by its political impact on the areas concerned. Its ultimate motivation is to export Communism. For example, a year ago Khrushchev stated,

"Another form of relations is that obtaining between Socialist countries and the economically underdeveloped countries. One may not of course say that in this case that our economic relations are based on mutual advantage. Speaking generally from the commercial viewpoint, our economic and technical aid to the underdeveloped countries is even unprofitable for us."

Soviet motivation behind much of the recently created trade activity between the Communists and the newly independent countries is, ultimately, to bring these countries into what Moscow calls, "the Socialist camp."

To summarize this overly long presentation, let me repeat a few points.

1. The Soviet Union views the future with confidence. They believe that their growing economy will overtake that of the United States in the next 10 years. While this is an exaggeration, there is no doubt that Soviet growth presents the United States with a most serious challenge.

2. The Soviet Union will be able to increase its military programs, to plow back more rubles into heavy industry, and to provide modest gains in the standard of living of the Russian people.

3. The muscle now exists to accelerate the export of Communism by economic means. Further, rapid economic growth serves as a powerful propaganda weapon in selling Communism to the new and fragile democracies who constitute the underdeveloped nations of the Free World.